pizza hut®, inc./1971 annual report

highlights

Total Revenue

Net Income

Per Share Income

Weighted average number of Common Shares outstanding

Working Capital

Total Assets

Stockholders' Equity

pizza hut®, inc./1971 annual report

1971	1970
$32,699,714	$24,717,221
$ 1,278,640	$ 1,041,851
$ .51	$ .42
2,497,141	2,497,306
$ 104,492	$ (100,826)
$16,661,059	$14,472,953
$ 9,575,380	$ 8,211,552

contents

The Annual Meeting of Stockholders will be on Tuesday, August 3, 1971, at 9:00 a.m. at the Ramada Inn in Wichita.

TRANSFER AGENTS: First National City Bank, New York City, and First National Bank in Wichita.
REGISTRARS: Franklin National Bank, New York City, and First National Bank in Wichita.
AUDITORS: Ernst & Ernst.

report to the stockholders

this year Pizza Hut, Inc. began to mature as a public company. The "shake out" in the fast food industry, coupled with a soft economy, was a significant test to our basic concepts of operation. Our stockholders can be assured we not only survived, but prospered. While such a year points out our strengths, it also makes our weakness and mistakes painfully apparent.

We are taking aggressive steps to capitalize on our profitable areas, and realistically work on our problems. Both of these situations will be more fully examined in this letter, after capsulizing our performance.

Total net sales for fiscal year ended March 31, 1971 were $31,067,034 . . . up from $23,382,341 . . . an increase of 32.9 percent. Net income increased 22.7 percent from the $1,041,851 reported last year to $1,278,640. Earnings per share showed a 21.4 percent increase, moving to 51¢ on 2,497,141 shares from 42¢ on 2,497,306 shares reported last year.

A 22.7 percent increase in income and earnings is cause for celebration in many corporate headquarters. But the 51¢ in earnings per share included 8¢ resulting from a tax savings. Earnings from operations were decreased by $179,000 or 7¢ per share as a result of non-recurring losses from unprofitable operations. These losses were charged to operations in fiscal 1971 and therefore, on a continuing basis, our earnings would reflect 50¢ per share.

The Taco Kid and Next Door divisions were both non-profitable for the same reasons. They were expanded too rapidly, and over too wide an area. Experience has shown us that numerical and geographic expansion must not proceed faster than the related management and support systems.

During this past year we took the following steps in Taco Kid and Next Door: (1) slowed expansion, (2) closed units in which the operating losses were greater than the fixed monthly costs, and (3) initiated programs to increase the volume and profitability of established units. These decisions have allowed our management, in these two divisions, to concentrate their efforts on those units where profitable results could be shown.

Taco Kid, now under the leadership of Jim McNerney, has responded well under this format. He and his people have decreased the operating loss significantly in the last few months.

Larry Payne is making progress with fewer Next Door units in our revised format, while Jim Anderson is testing the revised concept of a smaller unit designed for smaller cities.

The Pizza Hut Division under the direction of Darrel Rolph continues and will continue to dominate corporate activity. We are still in an accelerated expansion program, and during the last fiscal year the number of Pizza Huts increased to 667 . . . 139 more than a year ago.

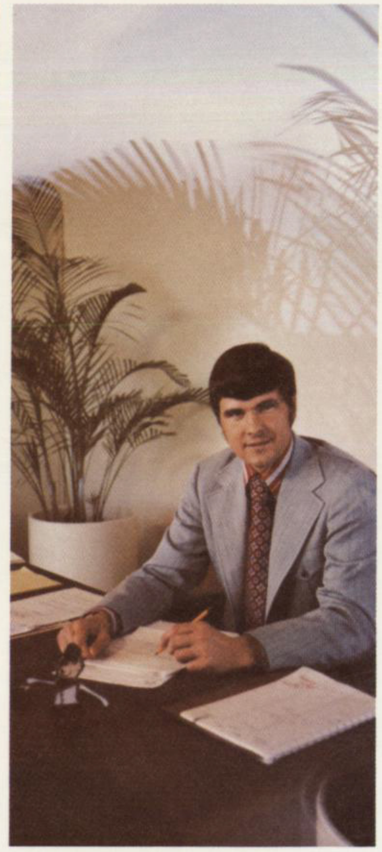
Pizza Huts are now located in 43 states and four foreign countries. At the end of the fiscal year 87 Pizza Huts were leased or under construction.

Company-owned unit growth is only a part of the Pizza Hut Story . . . the franchisees also play a major role in the development of the system. Our franchised growth has caused us to close franchising activity in the United States, except for our minority program, to all but people within the system.

Although there are many excellent one and two unit franchised operators, the main impetus for growth comes from our multiple operations groups. Our top ten groups, for instance, own in excess of 230 units and next year plan a minimum of an additional 70 units.

To strengthen our regular communication with our franchisees, we have instituted a Franchisee Advisory Board which meets quarterly so that a representative group can be used as a sounding board for company policies — the growth and direction of the chain. The benefit of this exchange cannot be expressed in dollars and cents, but must be considered a valuable company asset.

The pace in foreign development is quickening with Australia leading the way in current expectations. Jim McPeak's efforts in the Australian market place are achieving success both with company owned and franchisee development.



Frank Gordon and Stan Ostrowski have achieved product acceptance in Munich and are continuing company-owned unit development. We plan ultimately to have 25 to 30 company-owned units in Australia and a like number in Germany. European franchising should commence in late fiscal year 1972. We feel a strong operational base is necessary prior to franchising.

Our national advertising program, which includes company and franchisee units, dominates the pizza segment of the fast food industry. Our Research people have produced the "fast cook" oven to increase our effective unit capacity. Our Training Department has produced a high quality, low unit cost, audio-visual training program to provide better training for personnel at the retail level . . . a program

designed for increased profitability. Our Management Information Services people, in cooperation with the accounting section, have centralized our computerized operational control system.

The Flaming Steer project under Jim Aboud is continuing at a steady pace. Number one is showing good profit and number two opened this Spring in Topeka, Kansas. The initial volume indicates a profitable venture.

Franchise Services, Inc. is becoming more deeply involved in the distribution system. This system, optional for franchisees, delivers over 95% of the weekly needs to the door of the local Pizza Hut. The system now covers 239 operations, 112 company and 127 franchisees. FSI systems are currently being computerized for greater control.

This year we announced the acquisition of 80% of Ready Italy, Inc. with 20% being retained by Mr. Gene Cortese, the former owner/operator. Ready Italy is a frozen pizza crust company in Fargo, North Dakota supplying products to frozen food manufacturers. Pizza Hut uses no frozen crusts in its own units, but the frozen pizza market is expanding rapidly and should be fertile ground for the expertise your company is developing in its major product line.

Last year PHI entered into a joint venture with Sunflower Packing Company to form Sunflower Food Processors, Inc. This vendor supplies cooked sausage and beef toppings to many of our units. We entered into this arrangement because your Company needed the additional expertise for a serious entry into this market.

As you know, in early March we entered into negotiations with financially troubled Pizza Inn, Inc., a Dallas, Texas based chain. The reasons for Pizza Hut, Inc.'s involvement are (1) a potential increase in profits due to an increase in volume and a decrease percentage-wise in overhead, (2) the ease of assumption of operation because of the similarity of the concepts, (3) stronger national coverage with the addition of profitable, mature units, and (4) supplementary operational expertise from a similarly developed chain. As of this writing, Pizza Hut, Inc. has cancelled the merger agreement and is securing its collateral position under the terms of the Agreement in principle.

Corporate overhead has received increased attention. Adjustments are constantly being made to decrease our selling, general, and administrative expenses.

Our overall commitment is to our people, because only people produce profits and a return on investment for stockholders. Part of that commitment involves increased professional management training for our middle and top management groups. We are building a strong base with young, energetic management and they are developing and producing the programs that will carry Pizza Hut, Inc. for many profitable years to come.

Respectfully,

Frank L. Carney

Frank L. Carney,
President

Board of Directors and Corporate Officers

From left to right:

Robert K. Chisholm
Director

Robert E. Cressler
Vice President, Operations

Daniel J. Taylor
Treasurer

Frank L. Carney
President

Daniel M. Carney
Chairman of the Board

Joseph P. Flynn
Secretary

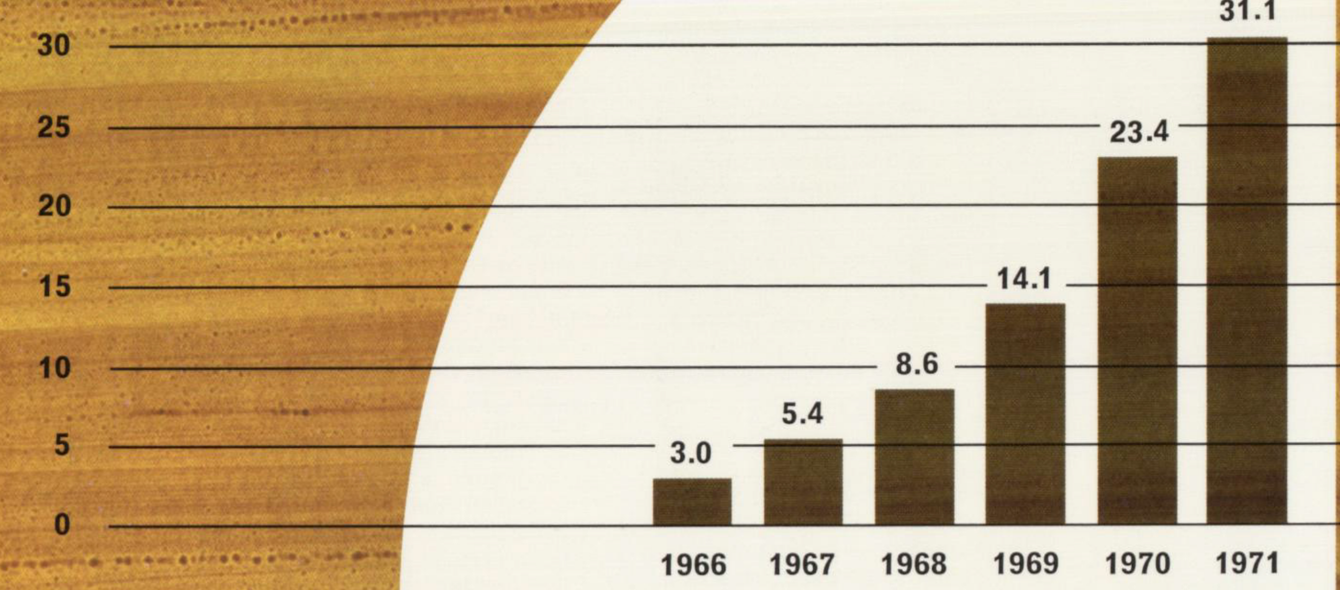
James P. Schwartz
Vice President, Finance

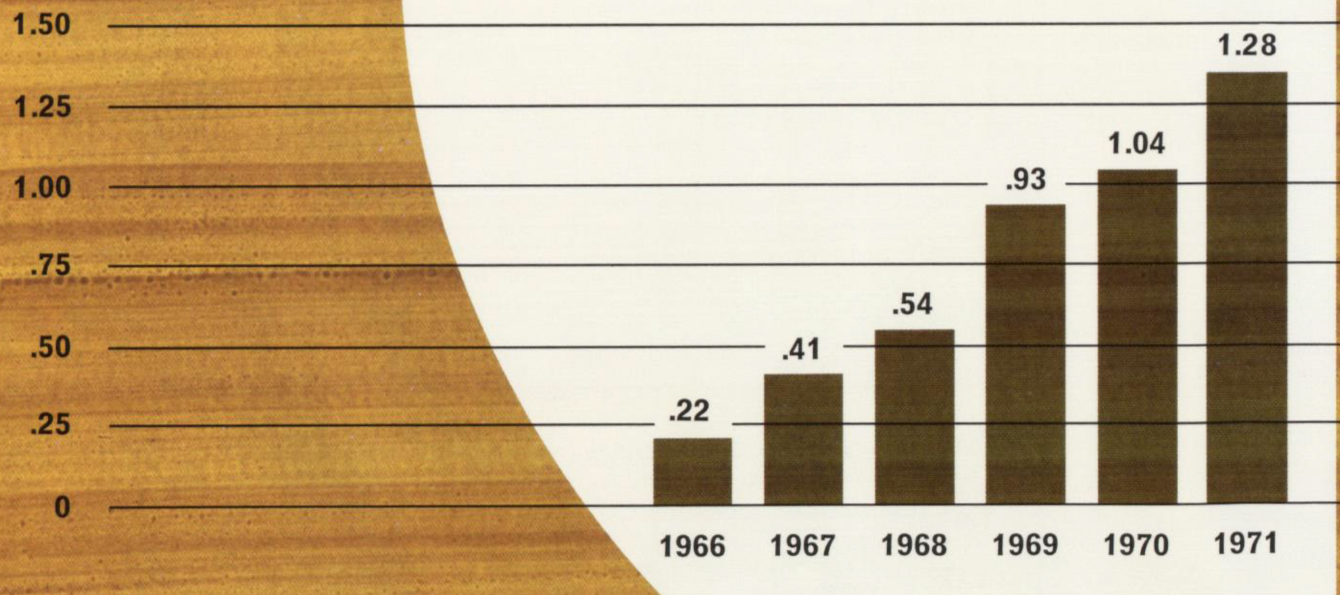
Martin Hart
Director

corporate growth trends

retail sales

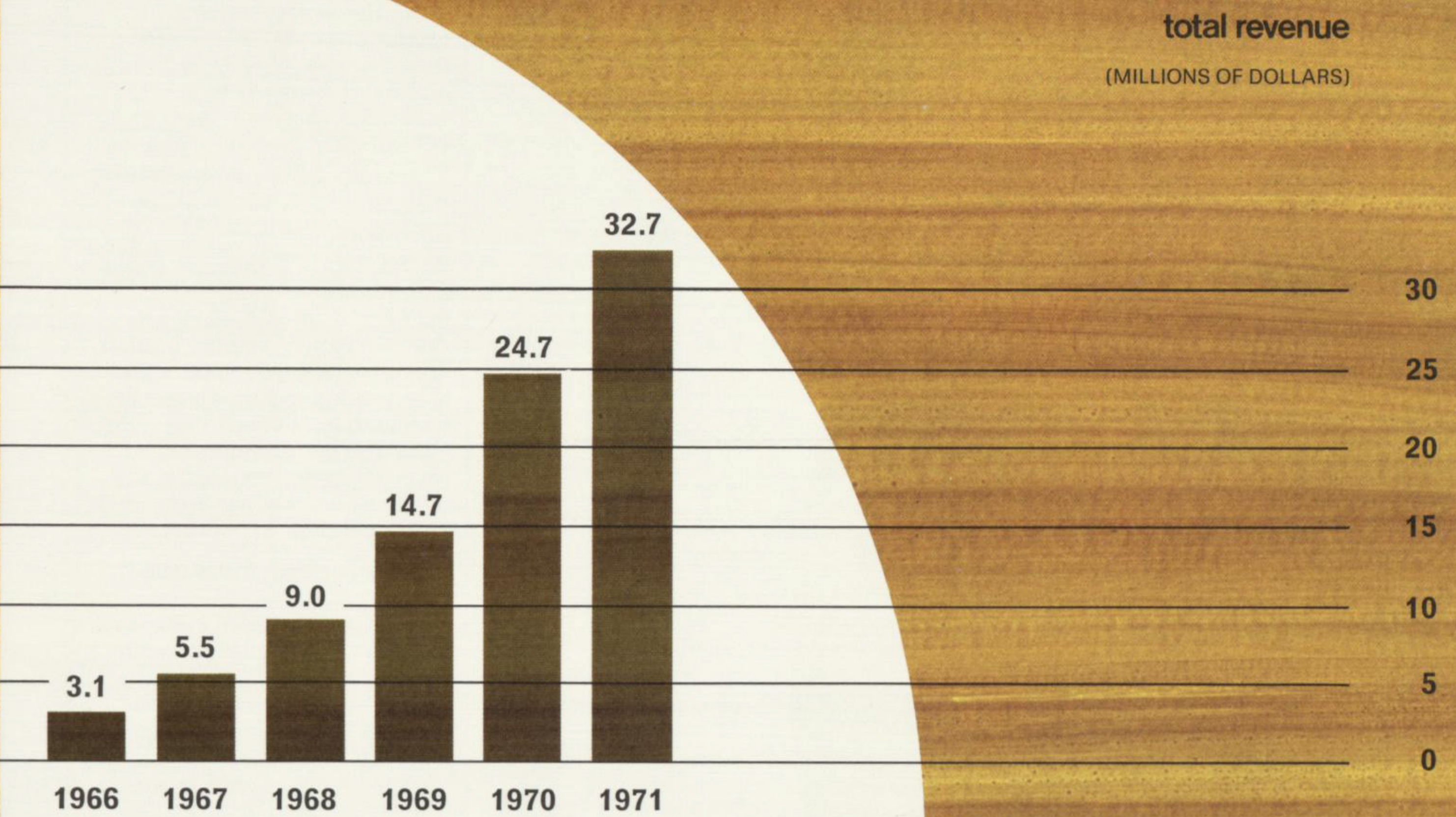
(MILLIONS OF DOLLARS)

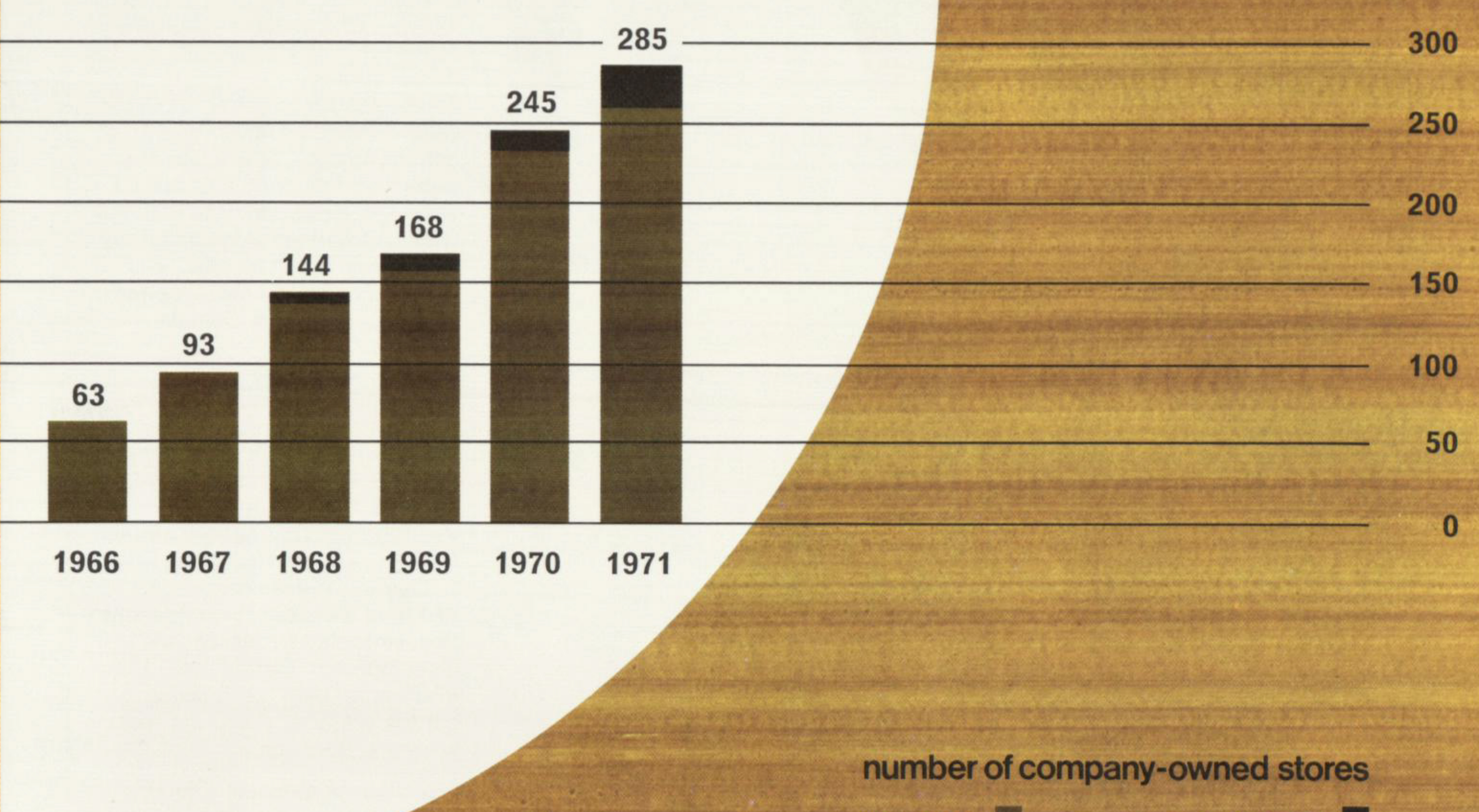




net income

(MILLIONS OF DOLLARS)


total revenue
(MILLIONS OF DOLLARS)
32.7
24.7
14.7
9.0
5.5
3.1
30
25
20
15
10
5
0
1966
1967
1968
1969
1970
1971


285
245
168
144
93
63
300
250
200
150
100
50
0
1966
1967
1968
1969
1970
1971
number of company-owned stores
PIZZA HUTS
OTHER STORES

pizza hut® history

The Pizza Hut Story, like every success story, is built on the timely action and correct decisions of earlier years. Nothing brings this into sharper focus than a review of the Pizza Hut history. It began with a new food idea, a small loan, two enterprising brothers with an eye on the future, and a partner with an art for making pizza.

In 1958 Daniel M. Carney, a Wichita State University graduate student, obtaining his masters degree in Business Administration, and his brother, Frank L. Carney, an undergraduate leaning toward electrical engineering, opened the first Pizza Hut in Wichita. Public response was immediate and a year later they had expanded their operation to five huts.

Highlights through the years include:
1959 — incorporation in Kansas; first franchise outlet opens in Topeka.
1962 — corporation buys out third partner; Robert Chisholm joins as Treasurer.
1963 — standard design for Huts is adopted.
1965-67 — continued growth of franchisee groups developing multiple operations.
1968 — PHI acquires capital stock of 129 franchisee corporations.
1969 — after meeting SEC requirements, 410,000 shares of common stock offered to the public on January 30. Acquired Taco Kid, Next Door and Flaming Steer operations. Also acquired Franchise Services, Inc. and J & G Food Co., Inc. Opened additional huts in Canada and Mexico.
1970 — new International headquarters formally opened by Kansas Governor, Robert B. Docking, Garner E. Shriver, Kansas' Fourth Congressional District Representative in Washington, Daniel M. Carney, Chairman of the Board and Frank L. Carney, PHI President. All PHI food divisions, management departments, Research and Development Center and the electronic data processing center are now operating from a central location.

PHI also announced a joint venture with the Sunflower Food Processors, Inc., which supplies a number of Pizza Hut operations.

An additional step into diversification in the food industry was the PHI acquisition of 80 percent of Ready Italy, Inc. The principal business of this company is the manufacturing of frozen pizza crusts for frozen food companies.

The purchase of Franchise Services, Inc. enabled PHI to expand their marketing and distribution facilities to all operations. J & G Products, the manufacturing division of Franchise Services, Inc., has begun moving into new quarters, which will substantially increase the PHI production capabilities.

An increase in PHI popularity overseas indicates that pizza also recognizes no language barrier. Australia's first hut, located in the Belfield District of Sydney, took only a few months to begin recording weekly sales figures far in excess of the U. S. national average amount.

There are now three franchised huts and one company-owned hut in Australia. In Germany, one hut is operating and another under construction is near completion. If the word pizza is not yet in the travel dictionary, it shouldn't be long before PHI puts it there.

pizza operations today

1971 was another year of successful operation for Pizza Hut, Inc. This fiscal year saw the addition of 139 Pizza Huts in the United States, with 100 of these huts added during the six-month peak construction period of March thru September. 1971 also saw expansion into the International scene with four huts in Australia and one in Germany.

During fiscal 1971, the Pizza Operations Department has worked diligently to tighten the control of daily hut operations. Effective January, 1971, Pizza Operations reorganized from six regions into three Wichita-based regions:
East, Central and West.

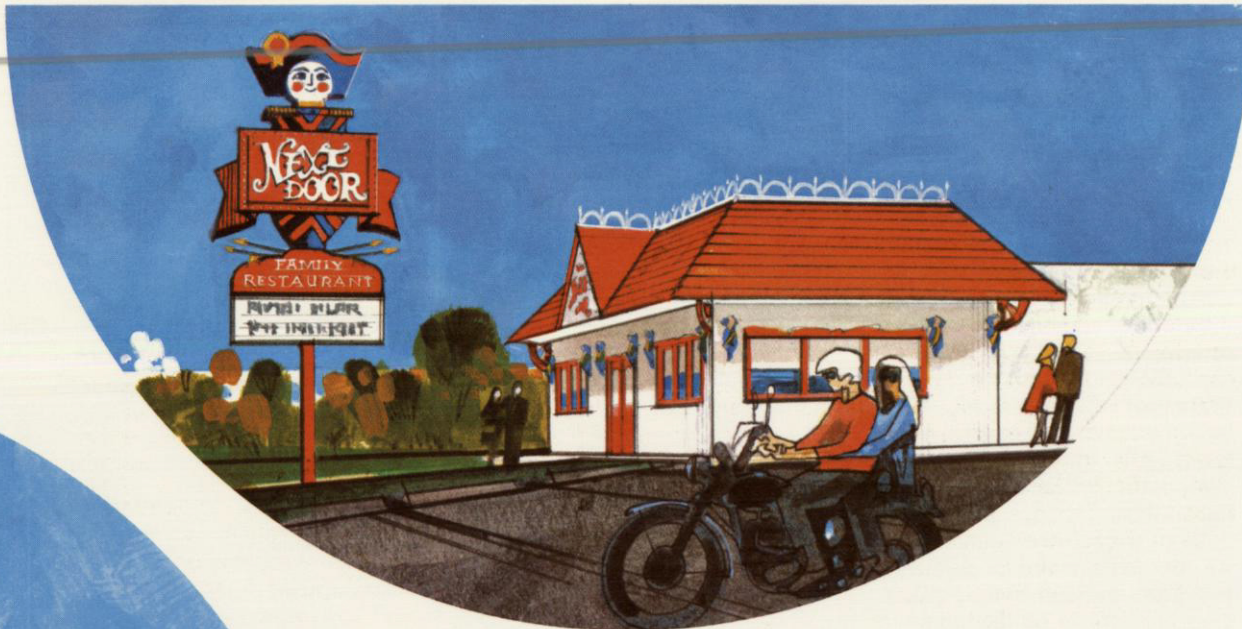
Key advantages for this restructuring to a home office base include more informed top operational management, better planning and control for the company's largest operating division, greater flexibility in moving swiftly to meet problem areas in the field, and a reduction in supervisory overhead.

This move also strengthens the field position of the Area General Managers by involving them more closely in the overall company management. Franchisees benefit by increased contact with experienced operational people familiar with the specific problems of their geographic section of the country.

Pizza Operations has begun a scheduled program of management training, in cooperation with the Training Department. This two-phase program starts with a one-week session of general training in company policies and procedures, along with presentations by all staff members to explain the functions of their various departments and how they can assist the field management personnel attain their goals.

Although the major effort of the Operations Department has been in the areas of control and management training, they have also instituted salad and sandwich programs in all huts.

Pizza Operations has introduced, and is using, a redesigned interior for new huts. The new interior features a combination of booths, tables and beamed ceilings to produce a warm, friendly atmosphere for Pizza Hut customers.



for a successful future

Eating out has become a way of life for American families. Over 40 billion meals were served in the United States last year, chosen from a wide variety of eating establishments.

One of these — Pizza Hut — providing a quality product in a distinctive atmosphere, is now the world's largest pizza specialty chain. The expanding population, and the increased activity in eating away from home points toward the need for additional well run, high quality food systems. PHI has moved toward that goal by acquiring Flaming Steer, Taco Kid and Next Door. The present operations of these three concepts are providing training, operating development and management analysis data to guide future development.

Last year Pizza Hut, Inc. announced the opening of the first Flaming Steer in Wichita. A second Flaming Steer Steak House is scheduled to open in May, 1971, in Topeka, Kansas. This was also the site of the first Pizza Hut outside Wichita.

Both units incorporate a Spanish-Mediterranean motif. The interior features a cathedral-type beamed ceiling with roomy, black leather booths for a warm, intimate atmosphere. The exterior is a unique six-sided design, and constructed from dark red brick and cedar.

A brick, open-hearth grill charbroils the house specialty — steak — in full view of diners. A varied menu of seafood, chicken, sandwiches, salads and desserts is offered and customers from the business world crowd Flaming Steer for lunch.

The addition of a private club called the Bum Steer is scheduled for both the Wichita and Topeka units.

PHI acquired 80 percent of the Flaming Steer concept in fiscal 1970. The remaining 20 percent has been retained by the developer, James J. Aboud, president of the Flaming Steer subsidiary.

The Taco Kid acquisition was made as an investment in the future. The Mexican food concept has popular appeal and a good prospect for profitability in properly managed locations.

In total, however, the Taco Kid Division has suffered because of an overemphasis on rapid expansion. The resulting strain on management control and related support systems caused outlets with good potential to suffer; and marginal outlets to sustain substantial losses.

An evaluation of this situation has led to a significant slowing of new unit construction, as well as the closing of units with losses in excess of fixed costs.

To date the results have supported the action. The Taco Kid division has definitely improved its financial picture.

We will consider further expansion of this program when existing units form a strong volume and profit foundation; and as management and control techniques are refined.

Present and future emphasis will be concentrated on the profitability of the existing 40x40 eat in — carry out units. The basic menu features tacos, tostados, burritos, taco burgers, frijoles, enchiladas and soft drinks.

The Next Door Division of PHI represents a vast marketing potential in the growing "family dining" food field. It has the elements for sound profitability, as evidenced by the success of the pilot unit.

The Next Door concept, however, is unlike other fast food divisions at PHI in that the menu is more complex and requires a greater investment in food preparation equipment, as well as more extensive management knowledge at the retail level.

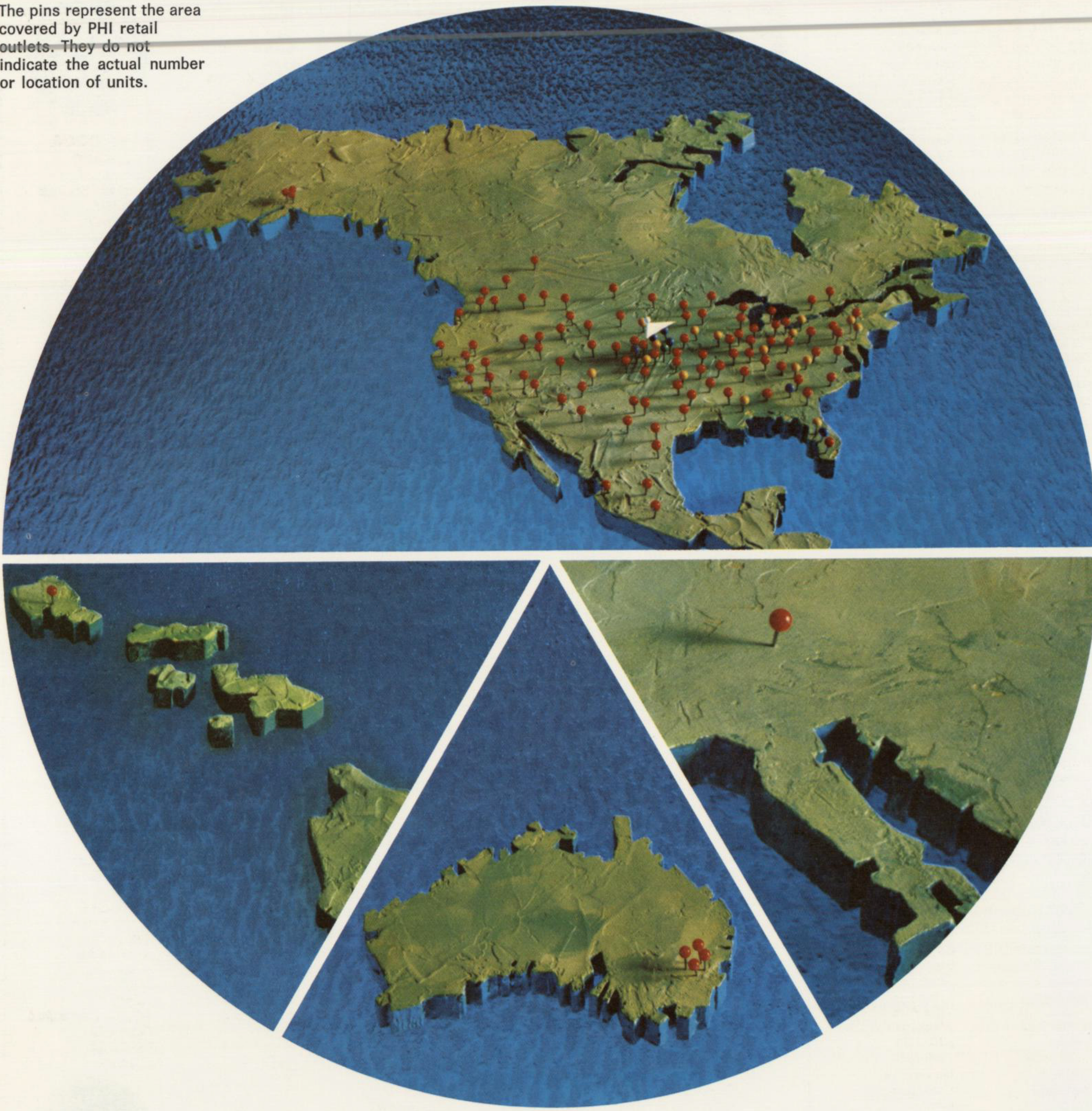
The first year of operation was hampered by an overly aggressive expansion program which spread operating units over too large a geographic area for effective management control. This operating problem was further compounded by spiraling land costs and increased costs in construction and equipment.

Management decisions have been implemented to resolve the problems of the Next Door division. Immediate action was taken to curtail expansion, and four non-profitable units were closed.

A development program is underway to lower the cost of the physical facility through modification of the building and equipment. The new floor plan provides smaller, more efficient food preparation and dining areas.

This revised concept, to be tested in the fall of 1971, will provide greater utilization of the facilities and reduce overhead — making the Next Door concept more suitable to city suburbs and smaller communities.

The pins represent the area covered by PHI retail outlets. They do not indicate the actual number or location of units.



pizza hut, inc.®

outlet locations

PIZZA HUT®

ALABAMA
Auburn
Huntsville
Mobile
Montgomery
Tuscaloosa
ALASKA
Anchorage
ARIZONA
Flagstaff
Phoenix
Tempe
Tucson
ARKANSAS
El Dorado
Fayetteville
Ft. Smith
Hot Springs
Little Rock
Pine Bluff
Texarkana
CALIFORNIA
Chatsworth
Chula Vista
Corona
Covina
El Cajon
Fontana
Fremont
Glendale
Glendora
Hawthorne
Hermosa Beach
Huntington Beach
Inglewood
La Mesa
Lawndale
Long Beach
Los Angeles
Millbrae
Mission Hills
Mountain View
National City
North Hollywood
Oakland
Ontario
Pasadena
Pomona
Reseda
Rialto
Sacramento
San Bernardino
San Carlos
San Diego
San Jose
Santa Clara
Santa Cruz
Santee
Sunnyvale
Torrance
Van Nuys
Venice
COLORADO
Aurora
Boulder
Colorado Springs
Denver
Ft. Collins
Golden
Greeley
Lakewood
Longmont
Pueblo
CONNECTICUT
Branford
Groton
Middletown
New London
Wallingford
FLORIDA
Atlantic Beach
Casselberry
Clearwater
Gainesville
Jacksonville
Lake Worth
Orlando
Palatka
Panama City
Pensacola
South Daytona Beach
South Pasadena
St. Petersburg
Tallahassee
Tampa
Titusville
West Palm Beach
Winter Haven
GEORGIA
Albany
Athens
Atlanta
Augusta
Brunswick
Columbus
Macon
Marietta
Savannah
Smyrna
Valdosta
Warner-Robins
HAWAII
Pearl City, Oahu
IDAHO
Sun Valley
Twin Falls
ILLINOIS
Aurora
Berwyn
Bloomington
Cahokia
Champaign
Chicago
Decatur
DeKalb
East Moline
Galesburg
Joliet
Lincoln
Lombard
Macomb
Mattoon
Montgomery
North Chicago
Pekin
Peoria
Peru
Quincy
Rantoul
Richton Park
Rockford
Romeoville
Springfield
Sterling
Streamwood
Urbana
Villa Park
Waukegan
INDIANA
Anderson
Clarksville
Columbus
Elkhart
Evansville
Hammond
Highland
Kokomo
Lafayette
Marion
Michigan City
Muncie
Richmond
South Bend
Terre Haute
IOWA
Ames
Ankeny
Atlantic
Bettendorf
Burlington
Clinton
Coralville
Council Bluffs
Davenport
Des Moines
Fairfield
Ft. Dodge
Indianola
Iowa City
Marshalltown
Mason City
Newton
Oskaloosa
Ottumwa
Waterloo
KANSAS
Arkansas City
Atchison
Coffeyville
Colby
Dodge City
El Dorado
Emporia
Great Bend
Hays
Hutchinson
Independence
Junction City
Kansas City
Lawrence
Leavenworth
Liberal
Manhattan
Newton
Olathe
Ottawa
Overland Park
Paola
Parsons
Pittsburg
Pratt
Salina
Shawnee
Topeka
Wellington
Wichita
KENTUCKY
Bowling Green
Frankfort
Lexington
Louisville
Middletown
LOUISIANA
Baton Rouge
Gretna
Kenner
Lake Charles
Metairie
New Iberia
New Orleans
Shreveport
MASSACHUSETTS
West Springfield
MICHIGAN
Battle Creek
Flint
Grand Rapids
Jackson
Kalamazoo
Wyoming
MINNESOTA
Albert Lea
Bloomington
Columbia Heights
Cottage Grove
Duluth
Falcon Heights
Mankato
Moorhead
Owatonna
Robbinsdale
Rochester
St. Cloud
St. Louis Park
St. Paul
West St. Paul
White Bear Lake
Winona
MISSISSIPPI
Hattiesburg
Jackson
Tupelo
MISSOURI
Chillicothe
Columbia
Florissant
Fulton
Gladstone
Hannibal
Independence
Jefferson City
Joplin
Kansas City
Kirksville
Liberty
Manchester
Marshall
Maryville
Mexico
Raytown
Rolla
Sedalia
Springfield
St. Charles
St. Joseph
St. Louis
Warrensburg
MONTANA
Billings
Great Falls
Helena
NEBRASKA
Beatrice
Bellevue
Columbus
Fremont
Grand Island
Hastings
Kearney
Lincoln
North Platte
Omaha
South Sioux City
NEVADA
Las Vegas
NEW HAMPSHIRE
Dover
Manchester
NEW MEXICO
Albuquerque
Clovis
Gallup
Hobbs
Las Cruces
Las Vegas
Roswell
Santa Fe
NEW YORK
Albany
Haverstraw
Ithaca
Rochester
Tonawanda
Westbury, L. I.
NORTH CAROLINA
Asheville
Burlington
Charlotte
Greensboro
Greenville
Raleigh
Reidsville
NORTH DAKOTA
Fargo
OHIO
Athens
Cincinnati
Columbus
Dayton
Findlay
Gahanna
Hamilton
Kent
Lancaster
Lorain
Milford
Oregon
Reynoldsburg
Sheffield Lake
Toledo
Vermilion
Youngstown
OKLAHOMA
Ada
Altus
Alva
Ardmore
Bartlesville
Chickasha
Duncan
Edmond
Guymon
Lawton
McAlester
Miami
Moore
Muskogee
Norman
Oklahoma City
Shawnee
Stillwater
Tulsa
Weatherford
Woodward
OREGON
Portland
PENNSYLVANIA
Allentown
Bethlehem
Lancaster
Pittsburgh
Reading
State College
SOUTH CAROLINA
Charleston
Columbia
Greenville
Myrtle Beach
Rock Hill
SOUTH DAKOTA
Aberdeen
Sioux Falls
TENNESSEE
Chattanooga
Cleveland
Knoxville
Memphis
Nashville
TEXAS
Abilene
Alice
Amarillo
Arlington
Austin
Beaumont
Bedford
Big Springs
Borger
Brownwood
Bryan
Canyon
Conroe
Corpus Christi
Dallas
El Paso
Ft. Worth
Galveston
Garland
Haltom City
Hereford
Houston
Irving
Kingsville
Longview
Lubbock
Lufkin
Midland
Monohans
Nacogdoches
Odessa
Orange
Pampa
Plainview
Port Arthur
San Angelo
San Antonio
Temple
Tyler
Victoria
Waco
Wichita Falls
UTAH
Granger
Murray
Ogden
Provo
Salt Lake City
St. George
VIRGINIA
Arlington
Blacksburg
Bristol
Collinsville
Hampton
Harrisonburg
Lynchburg
Manassas
Newport News
Richmond
Roanoke
Staunton
Vienna
Waynesboro
Winchester
WASHINGTON
Ellensburg
Olympia
Seattle
Spokane
WEST VIRGINIA
Beckley
Charleston
Huntington
St. Albans
South Charleston
WISCONSIN
Appleton
Beloit
De Pere
Eau Claire
Fond Du Lac
Green Bay
Janesville
Kenosha
La Crosse
Madison
Milwaukee
Neenah
Racine
Sheboygan
Stevens Point
Wausau
Wisconsin Rapids
CANADA
Edmonton
North Burnaby
Richmond
Surrey
Vancouver
North Vancouver
Winnipeg
MEXICO
Acapulco
Guadalajara
Mexico City
Monterrey
AUSTRALIA
Sydney
Warrawong
GERMANY
Munich

NEXT DOOR

COLORADO
Aurora
Colorado Springs
INDIANA
Clarksville
IOWA
Des Moines
KANSAS
Overland Park
Wichita
OKLAHOMA
Tulsa
TEXAS
Carrollton
Richardson

TACO KID

COLORADO
Aurora
Boulder
Colorado Springs
FLORIDA
Pensacola
GEORGIA
Atlanta
Marietta
ILLINOIS
Urbana
INDIANA
Evansville
Hammond
IOWA
Cedar Rapids
Des Moines
KANSAS
Emporia
Junction City
Kansas City
Wichita
NEBRASKA
Grand Island
Lincoln
NEW YORK
Rochester
OHIO
Toledo
SOUTH CAROLINA
Columbia
VIRGINIA
Roanoke

FLAMING STEER

KANSAS
Topeka
Wichita

pizza hut®, inc.... people....progress

People are the major ingredient in the success of PHI . . . People at both the retail and the management levels. By working together, they have made your company the leader in its field.

PHI history shows that future managers often begin in the retail operations, where they are able to learn the very basics of a complex business. The strong lines of communication between all areas of operation allow PHI to develop these future managers.

Yearly regional meetings to provide a two-way communication between the home office and specific field problems, play an important role in keeping every employee a vital part of the total program. Area General Managers visit individual Pizza Huts to supervise operations, quality and profitability.

New Area General Managers receive an intense two-phase training program which combines classroom and on-the-job training.

Training and indoctrination programs for the retail organization is provided by a portable, high quality, low unit cost audiovisual unit. These movie/sound presentations are available to each retail location through the Area General Manager. Subjects covered include customer relations, product preparation and waitress training. Additional subjects will be available in the near future.

People are the key to PHI success. And we are fortunate in having people who care about maintaining a quality product and quality service.

franchise services, inc.

Service is the key word at Franchise Services, Inc. This operation gives Pizza Hut, Inc. the capability to offer both company units and franchisees a single source of equipment and supplies at competitive prices. This also makes it possible to eliminate costly commissary facilities, excess inventory and expensive management time.

Last November, FSI established truck routes and schedules to service the PHI nationwide organization. Already forty-foot trucking rigs log 38,500 miles a month. Deliveries have increased from half a million pounds per month to more than a million and a half pounds.

Computerizing location numbers for warehouse items has resulted in considerable dollar savings by shortening the time needed to locate, stage and ship orders.

J & G Products, the manufacturing division of FSI has occupied new quarters (30,000 sq. ft.) and includes a mill shop which constructs booths, table tops and Pizza logo signs; a sewing shop, where Pizza Hut and Next Door uniforms are made; the silk screen area where approximately 50 sets of 5-foot Pizza men are painted each month, as well as the promotional banners used by the Huts. Forty thousand "goodie bags" (basic pizza spices) are blended each month; and in addition other combinations of spices are blended for tacos, sausage, spaghetti, chili and hamburgers.

J & G Products uses over 13,000 pounds of wax each month to pour 1200 cases of candles. It has its own sheetmetal shop to manufacture candle holders and table arrangers; and an upholstery shop and cutting tables to manufacture the durable naughahyde tablecloths. Employees are trained in multiple functions so that production schedules can be planned for maximum utilization of personnel.

The ultimate goal of FSI, as with all institutional suppliers, is to provide PHI operations quality products, when they need it, and at the lowest possible cost.

management information services

Every successful corporation must recognize the need for accurate and timely financial reporting. This premise was the basis for establishing a department of Management Information Services, whose primary function is to provide company management with pertinent information from all areas of the organization.

In June, 1970 an IBM System 360 computer was installed with both tape and disc capabilities. The physical facilities include 2000 square feet of raised computer flooring and 1000 square feet in the keypunch area. A precise environmental system is in operation 24 hours a day to control temperature and humidity, which is mandatory to an efficient data processing operation.

Computerized accounting and operational procedures include centralized bill paying for all Pizza Hut, Next Door and Taco Kid operations; centralized payroll for all company employees; a weekly summary of all field input; preparation of financial statements for each unit, area and region, as well as a consolidated report reflecting the combined financial position of PHI and all subsidiary operations.

The MIS department is organized under two distinct functions . . . data processing operations and systems and programming.

The Systems and programming function is geared to work with and for all departments in developing and implementing successful systems. The objective of each system is to satisfy the user departments' information requirements, thus increasing the potential for profit through better control. Long-range plans for the computer include developing a centralized information system by integrating accounting, financial, sales, operational and historical information into a central data base system.

research and development

although the laboratory seems an unlikely place to find pizza, it's not at all unusual in the PHI Research and Development Department. R & D began in 1969 with limited laboratory facilities, but now the section uses sophisticated equipment designed to aid in quality control, cost reduction, the development of new products, and the evaluation of equipment.

The quality control and food production techniques developed by R & D is one of the primary reasons for PHI's leadership position among pizza specialty chains. One such machine that contributes to this high quality level is the fat extractor which indicates the percentage of fat in a given sample of meat. A high fat content produces a soggy pizza — a low content results in dry tasteless meat.

The Centrifuge aids in determining the fat content of cheese as well as the amount of time which will elapse before a salad dressing will separate. The vacuum oven determines moisture content of meats and cheese. The pH meter tests acid content of cheese and tomatoes — all factors contributing to the quality of our pizza.

Suggestions submitted for menu diversification are tested and evaluated by this department. Taste panels are scheduled regularly to test a wide variety of items. Panelists record their opinions which are later used as a part of the total evaluation of the test item. Luncheon programs for the Pizza Huts, utilizing salads and submarine sandwiches, were developed in this department.

Other products created in the R & D kitchen include spaghetti; baked beans and onion rings (for the Next Door program); baked chicken and gravies (used at Flaming Steer); hot sauces (for Taco Kids) and the meatball sandwich (still in the testing stage).

In addition to maintaining a high quality control, and expanding menu selections, cost reduction is often dramatic after R & D evaluates a product. Incubators are used to grow bacteria in food samples. A product with a high number of bacteria will spoil faster, thereby increasing food costs.

Once cheese was purchased in bulk and sliced in the Huts. Pre-sliced cheese has been found to save time and maintain more consistent quality.

All equipment used in the retail units is tested by R & D for total evaluation. Quick recovery ovens are a prime example of this program. To solve a problem created by heat loss from opening oven doors, R & D designed and tested a new oven concept which was adopted and is being manufactured by a PHI supplier. All ovens now purchased are this design: however, another major contribution by this department was the simultaneous development of an inexpensive kit to convert ovens already in use.

Outside companies contribute to the utilization of this well-equipped laboratory by contracting for development and quality control of their products by the PHI Research and Development department.

franchising

The first Pizza Hut franchisee was an employee who wanted to go to another area to start his own group of huts. This first move into franchising proved to be the basis for all PHI franchise agreements, even today; they all stipulate that any franchise is required to have operational ownership.

Most franchisees have been with the company for many years, with their growth and management expertise paralleling that of PHI. As a group they display loyalty and the strength of character that every company needs for success.

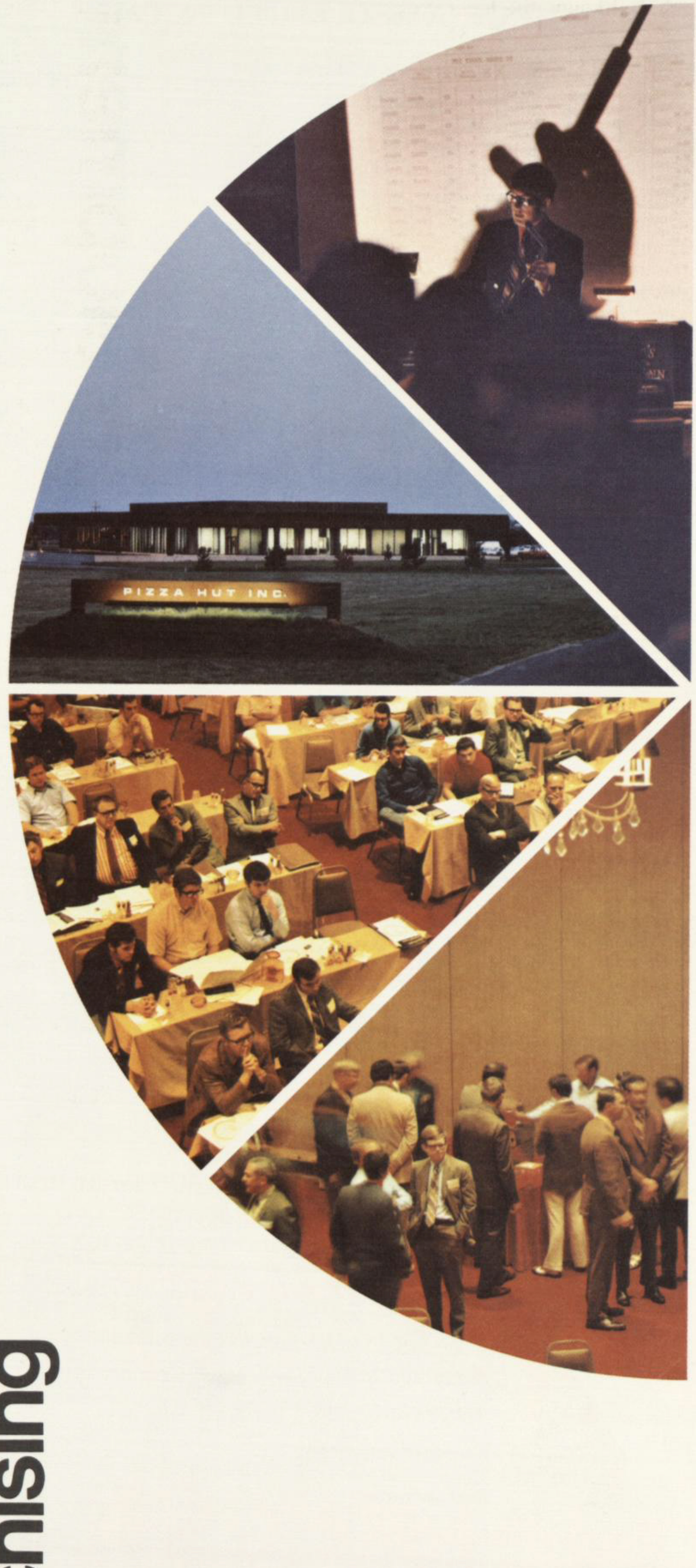
The Franchise Service Center, an integral part of the Franchise Department, at PHI corporate headquarters in Wichita, is the primary source of communication between the franchisees and company management. The Center is responsible for maintaining and channeling the immense flow of data between the company and its franchisees on a timely basis.

To supplement this line of communication, the company also publishes a monthly newsletter which is sent to all franchisees and includes news articles and management information of general interest to everyone in the system.

Regional meetings are held once a year for the specific purpose of providing franchisees, company field and staff personnel an opportunity to exchange ideas and discuss any problem areas. In addition, the company Area General Managers visit all franchise huts in their respective areas at least quarterly to assist franchisees in their operations.

Over 90 percent of the franchisees belong to the International Pizza Huts Franchise Holders Association (IPHFHA) which was organized to develop a national advertising program in 1968. In addition, IPHFHA sponsors group and casualty insurance programs, and makes it possible for franchisees to participate in a credit union.

The association of ideas, harmony of goals and unity of purpose which exist between PHI and franchisees is responsible for the rapport developed at all company levels. This rapport is in large measure responsible for the success of the PHI franchise system.



STATEMENT OF CONSOLIDATED INCOME

Pizza Hut, Inc. and Consolidated Subsidiaries

	Year Ended March 31	
	1971	1970
Net sales	$31,067,034	$23,382,341
Cost of sales	11,181,948	8,089,492
	19,885,086	15,292,849
Initial franchise fees	429,534	505,434
Continuing franchise fees	936,863	580,371
	21,251,483	16,378,654
Selling, general, and administrative expenses	19,075,767	14,481,619
	2,175,716	1,897,035
Other income (including interest: 1971 — $116,227 and 1970 — $102,713)	266,283	249,075
	2,441,999	2,146,110
Interest expense	308,359	150,759
INCOME BEFORE INCOME TAXES AND EXTRAORDINARY ITEM	2,133,640	1,995,351
Federal and state income taxes — Note D		
Current	802,000	1,101,500
Deferred (credit)	266,000	(148,000)
	1,068,000	953,500
INCOME BEFORE EXTRAORDINARY ITEM	1,065,640	1,041,851
Extraordinary item — reduction in income taxes resulting from the carry-forward of net operating losses	213,000	
NET INCOME	$ 1,278,640	$ 1,041,851
Net income per share of Common Stock:		
Weighted average shares of Common Stock outstanding	2,497,141	2,497,306
Net income before extraordinary item	$.43	$.42
Extraordinary item	.08	
Net income	$.51	$.42

See notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEET

Pizza Hut, Inc. and Consolidated Subsidiaries

ASSETS	March 31, 1971	March 31, 1970
CURRENT ASSETS		
Cash	$ 963,179	$ 876,005
Trade and other receivables — less allowance of $60,000 in 1971, and $45,000 in 1970 — Notes B and G	2,014,183	1,740,467
Inventories — at lower of cost (first-in, first-out method) or market — Note B	1,166,461	952,616
Prepaid expenses	228,360	291,025
TOTAL CURRENT ASSETS	4,372,183	3,860,113
OTHER ASSETS		
Investments in and advances to affiliates and foreign subsidiaries — Note A	290,984	116,921
Miscellaneous deposits and accounts	638,580	598,218
Notes receivable	430,375	331,000
Note receivable from officer	70,000	
Cost in excess of net assets of businesses acquired — Note A	566,420	421,866
Patents, service marks, and franchises	110,407	113,132
	2,106,766	1,581,137
PROPERTY, PLANT, AND EQUIPMENT — on the basis of cost — Notes B and C		
Land	2,346,115	2,514,550
Buildings and improvements	1,646,565	2,283,119
Operating equipment	4,114,282	3,229,736
Leasehold improvements	1,842,099	925,705
Construction in progress (estimated cost to complete — $700,400)	386,607	
Cash and investments appropriated for completion of construction in progress	594,971	
Allowance for depreciation and amortization (deduction)	(1,576,416)	(1,067,670)
	9,354,223	7,885,440
DEFERRED CHARGES — Note C		
Unamortized organization (1971 — $94,833; 1970 — $138,679) and reorganization expenses	418,268	487,463
Deferred income taxes — Note D	282,000	548,000
Unamortized deferred site development costs	127,619	110,800
	827,887	1,146,263
	$16,661,059	$14,472,953
LIABILITIES		
CURRENT LIABILITIES		
Notes payable — Note B		
To banks	$ 1,342,488	$ 1,145,295
To others	462,078	218,989
Trade accounts payable and accrued expenses	1,686,901	1,464,192
Income taxes — Note D	517,664	953,866
Current portion of long-term debt	258,560	178,597
TOTAL CURRENT LIABILITIES	4,267,691	3,960,939
LONG-TERM DEBT — Note B	2,301,988	1,256,837
DEFERRED INITIAL FRANCHISE FEE INCOME	516,000	1,043,625
STOCKHOLDERS' EQUITY — Note E		
Preference Stock, par value $0.01 a share; Authorized 1,000,000 shares — none issued		
Common Stock, par value $0.01 a share; Authorized 10,000,000 shares	25,097	25,069
Other capital	341,524	341,524
Additional paid-in capital	6,363,892	6,315,909
Retained earnings	2,844,867	1,529,188
Treasury stock (1970 — 13,791 shares) at par value (deduction)		(138)
	9,575,380	8,211,552
COMMITMENTS AND CONTINGENT LIABILITIES — Note F		
	$16,661,059	$14,472,953

See notes to consolidated financial statements.

STATEMENT OF CONSOLIDATED STOCKHOLDERS' EQUITY

Pizza Hut, Inc. and Consolidated Subsidiaries

Years ended
March 31, 1971, and March 31, 1970

	Common Stock Shares	Common Stock Amount	Other Capital	Additional Paid-in Capital	Retained Earnings	Treasury Stock
Balance at March 31, 1969	2,489,912	$24,899	$341,524	$5,930,565	$ 854,091	$ ——
Acquisition of purchased companies	16,991	170		418,426		
Cancellation of options for 1,037 shares				(259)		
Treasury stock (13,791 shares) purchased				(32,823)	(346,292)	(138)
Adjustment for net income of pooled businesses duplicated in conformity with Pizza Hut, Inc.'s fiscal year					(5,378)	
Dividends declared by pooled companies before acquisition					(15,084)	
Net income					1,041,851	
BALANCE AT MARCH 31, 1970	2,506,903	25,069	341,524	6,315,909	1,529,188	(138)
Treasury stock (13,791 shares) sold to an officer				32,823	37,039	138
Acquisition of purchased companies — Note A	2,750	28		15,098		
Sale of stock options for 250 shares				62		
Net income					1,278,640	
BALANCE AT MARCH 31, 1971	2,509,653	$25,097	$341,524	$6,363,892	$2,844,867	$ ——

See notes to consolidated financial statements.

STATEMENT OF CHANGES IN CONSOLIDATED FINANCIAL POSITION

Pizza Hut, Inc. and Consolidated Subsidiaries

	Year Ended March 31	
	1971	1970
SOURCE OF FUNDS		
Net income for the year	$1,278,640	$1,041,851
Charges to income not affecting funds:		
Depreciation and amortization	683,506	557,907
Decrease (increase) in deferred income taxes	266,000	(148,000)
TOTAL FROM OPERATIONS	2,228,146	1,451,758
Proceeds from long-term debt	1,365,909	582,900
Disposals of property, plant, and equipment	2,596,615	233,101
Sale (purchase) of treasury stock (13,791 shares)	70,000	(379,253)
Issuance of Common Stock	15,126	418,596
Other items	62	(20,721)
	6,275,858	2,286,381
LESS APPLICATION OF FUNDS		
Additions to property, plant, and equipment	4,642,485	5,467,873
Reduction of long-term debt	320,758	146,729
Decrease (increase) in deferred initial franchise fees	527,625	(299,625)
Increase in organization expenses and site development costs	39,591	208,517
Increase in other assets		
Investments in and advances to affiliates and foreign subsidiaries	174,063	83,022
Miscellaneous deposits and accounts	42,828	262,922
Notes receivable	99,375	331,000
Note receivable from officer	70,000	
Cost in excess of net assets of businesses acquired	147,490	421,866
Patents, service marks, and franchises	6,325	98,886
	540,081	1,197,696
	6,070,540	6,721,190
INCREASE (DECREASE) IN WORKING CAPITAL	$ 205,318	($4,434,809)
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in working capital:		
Cash	$ 87,174	($1,863,366)
Marketable securities		(3,363,172)
Trade and other receivables	273,716	1,203,466
Inventories	213,845	481,324
Prepaid expenses	(62,665)	69,499
Notes payable and current portion of long-term debt	(520,245)	(789,084)
Trade accounts payable and accrued expenses	(222,709)	(347,076)
Income taxes	436,202	173,600
INCREASE (DECREASE) IN WORKING CAPITAL	$ 205,318	($4,434,809)

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Pizza Hut, Inc. and Consolidated Subsidiaries

March 31, 1971

NOTE A — ACCOUNTING PRINCIPLES

The consolidated financial statements include the accounts of all majority held domestic subsidiaries after elimination of significant inter-company accounts and transactions. The investment in foreign subsidiaries is carried at cost which approximates the Company's equity in the foreign subsidiaries' net assets.

During the year ended March 31, 1971, the Company acquired controlling interests in three corporations for 2,750 shares of its Common Stock and $30,000 cash in transactions accounted for as purchases. Accordingly, the operations of these businesses have been included since date of acquisition. The cost in excess of net assets acquired in these transactions of $60,203 is being amortized over periods varying from 5 to 40 years. The results of operations of the acquired corporations for the current and immediately preceding periods were not material in relation to the Company's operations.

The cost in excess of net assets acquired in transactions accounted for as purchases in prior years ($421,866) was not amortized, since in the opinion of management, there has been no diminution in value.

NOTE B — NOTES PAYABLE AND LONG-TERM DEBT

The Company has pledged inventory in the amount of $562,262 and accounts receivable of $1,031,059 as security to a current note payable to others having an unpaid balance of $378,829. All other current notes payable to banks and others are unsecured.

At March 31, 1971, and March 31, 1970, the Company and its consolidated subsidiaries were indebted under long-term debt agreements as follows:

	1971	1970
Mortgage notes due in monthly installments aggregating $15,860, including interest at rates of 6% to 9½%, maturing at various dates to 1989. Land, buildings, and leasehold improvements with a carrying value of $1,605,961 have been mortgaged as collateral	$1,206,352	$1,015,247
Capitalized lease obligation payable to 1985 in increasing monthly installments, including interest from 7½% to 8¼%	975,000	
6% real estate mortgage notes due in 1971. Land with a carrying value of $90,439 has been mortgaged as collateral		70,000
Equipment notes requiring monthly payments of $4,895 to 1974, including interest at rates of 5% to 15%. Equipment with a carrying value of $169,549 has been mortgaged as collateral	137,536	48,550
8½% unsecured note due in monthly installments of increasing amounts ranging from $4,000 to $12,000 plus interest through January 1, 1973	195,000	225,000
Other unsecured notes	46,660	76,637
	2,560,548	1,435,434
Less amounts due within one year	258,560	178,597
	$2,301,988	$1,256,837

The aggregate maturities for each of the five years ending March 31, 1976, are as follows: 1972 — $258,560; 1973 — $328,137; 1974 — $184,482; 1975 — $177,992; 1976 — $182,533.

NOTE C — DEPRECIATION AND AMORTIZATION POLICY

Provision for depreciation of buildings and equipment was made on a basis considered adequate to amortize the cost of the depreciable assets over their estimated lives by the straight-line and accelerated methods. Leasehold improvements were amortized by the straight-line method. Such amounts for the year ended March 31, 1971, totaled $577,087 and were computed generally on the basis of the following range of lives:

Buildings and improvements	20 to 30 years
Operating equipment	5 to 10 years
Leasehold improvements	Term of lease

Repairs, maintenance, and renewals were charged to income. Expenditures for improvements have been capitalized. The policy of the Company and subsidiaries is to relieve property accounts and related allowances for properties retired, or otherwise disposed of, at amounts included therein for such properties, and any gain or loss resulting therefrom has been included in the Statement of Consolidated Income.

The Company is amortizing organization expenses and deferred site development costs over a five year period and reorganization expenses over a fifteen-year period, both on a straight-line basis. Such amortization during the year ended March 31, 1971, totaled $106,419.

NOTE D — INCOME TAXES

The provision for federal income taxes in prior years was made on the basis of filing separate returns for each subsidiary. It is management's intention to file its federal income tax return for the year ended March 31, 1971, on a consolidated basis.

Deferred income taxes arise from the deferral of initial franchise fee income for accounting purposes until the related retail unit has been opened by the franchisee.

NOTE E — CAPITAL STOCK

At March 31, 1971, options to acquire 32,220 shares of Common Stock had been granted to officers and employees and 67,780 shares were reserved for future grants. Options granted are exercisable at $9.38 per share, the market value at the date of grant. On December 26, 1970, 25% of the options became exercisable and another 25% become exercisable annually thereafter. At March 31, 1971, none of the options had been exercised.

NOTE F — COMMITMENTS AND CONTINGENT LIABILITIES

At March 31, 1971, the Company and subsidiaries were lessees under long-term leases for buildings and equipment expiring through the year 2008. These leases call for minimum annual rental (exclusive of real estate taxes, maintenance, and insurance payments required by some of the leases) of $3,746,180. The aggregate rental commitment under these leases was $51,606,908 of which $3,785,719 represented the approximate aggregate commitment on leases, which at March 31, 1971, covered locations where operations had been suspended. Certain of the leases provide for additional annual rent based on gross sales of the operating hut.

At March 31, 1971, the Company was guarantor of the lease commitments of certain franchisees. The minimum annual and aggregate rentals of such leases were $571,848 and $14,500,385 respectively. The Company has also guaranteed certain debt obligations of franchisees and unconsolidated subsidiaries in the approximate amount of $425,000.

The Company is a party to pending or threatened lawsuits arising from the normal conduct of its business. While it is not possible to forecast the results of these matters, management believes the outcome will not have a material adverse effect on the Company's financial position.

NOTE G — SUBSEQUENT EVENTS

Included in trade and other receivables at March 31, 1971, was $350,000 due from Pizza Inn, Inc. Subsequent to year end, this amount increased to $400,000. Under the terms of the agreement, the Company had been granted a security interest in certain retail operating subsidiaries, 180,000 shares of Pizza Inn, Inc. Common Stock, and an assignment of continuing franchise fees. Effective June 15, 1971, Pizza Inn, Inc. was in default of certain provisions of the loan agreement. On or before June 19, 1971, Pizza Hut, Inc. accepted and assumed ownership and control of the retail operating subsidiaries of Pizza Inn, Inc. pursuant to the terms and provisions of the documents evidencing and securing the above indebtedness and the statutory procedures pertaining thereto. It is the opinion of legal counsel that by reason of the assumption of ownership and control of these corporations the indebtedness has been fully paid.

ACCOUNTANTS' REPORT

ERNST & ERNST

500 FARMERS & BANKERS BUILDING

WICHITA, KANSAS 67202

Stockholders and Board of Directors
Pizza Hut, Inc.
Wichita, Kansas

We have examined the consolidated financial statements of Pizza Hut, Inc. and subsidiaries for the year ended March 31, 1971. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously made a similar examination of the financial statements for the preceding year.

In our opinion, the accompanying balance sheet and statements of income, stockholders' equity, and changes in financial position present fairly the consolidated financial position of Pizza Hut, Inc. and subsidiaries at March 31, 1971, and the consolidated results of their operations, changes in stockholders' equity, and changes in financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Ernst & Ernst

Wichita, Kansas
June 23, 1971

DIRECTORS

Daniel M. Carney,
Chairman of the Board
Frank L. Carney,
President and Chief Operating Officer
Robert K. Chisholm,
Investments
James P. Schwartz,
Vice President - Finance
Martin Hart,
Investments

PRINCIPAL OFFICERS

Frank L. Carney,
President and Chief Operating Officer
James P. Schwartz,
Vice President - Finance
Robert E. Cressler,
Vice President - Operations
Daniel J. Taylor,
Treasurer
Joseph P. Flynn,
Secretary and Counsel

EXECUTIVE PERSONNEL

Accounting
Daniel J. Taylor, Director
Max Sutton, Controller
Construction
Gene W. Danitschek, Director
Corporate Information
Farris S. Farha, Director
Real Estate Development
John H. Songer, Director
Theodore A. Swan, Assistant Director
Franchise
Kenneth R. Miller, Director
Legal
Joseph P. Flynn, General Counsel
Gerald T. Aaron, Assistant Counsel
Management Information Services
Robert J. Navrat, Director
Hal W. McCoy, Manager of Systems and Programming
Charles S. Brown, Manager of EDP Operations
Office Services and Personnel
Lois Bird, Director
Operations
Pizza
Darrel L. Rolph, Director
Jack L. Shelton, Assistant to the Director
Eldon D. Amandus, Assistant to the Director
Richard M. Bennett, Western Region Mgr.
James E. O'Donnell, Central Region Mgr.
Robert A. Geist, Eastern Region Mgr.
Flaming Steer
James J. Aboud, Director
Taco Kid
Jim McNerney, Director
Mike O'Rourke, Assistant Director
Next Door
Larry F. Payne, Director
Jim L. Anderson, Regional Manager
Gary R. Moore, Assistant Director
Research and Development
M. Hal Taylor, PhD
Training
Christopher F. Hotze, Director

INTERNATIONAL SUBSIDIARIES

Pizza Hut Australia Pty. Ltd.
James McPeak, Managing Director
Pizza Hutte, GmbH (West Germany)
Frank Gordon, Managing Director
Stanley T. Ostrowski, Director of Operations

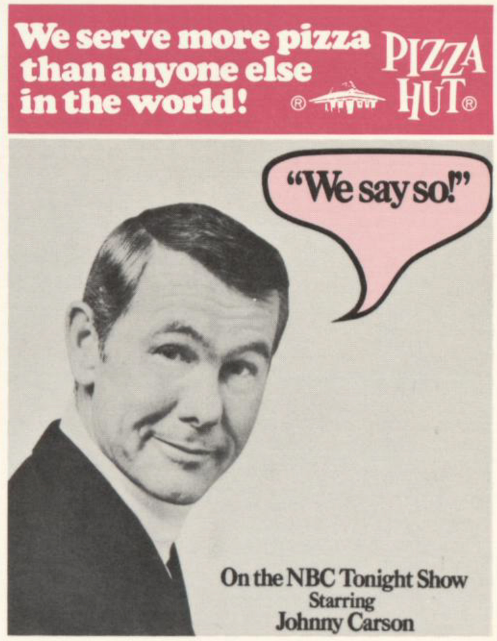
SUBSIDIARIES

Franchise Services, Inc.
Farris S. Farha, President
Dale E. Wiggins, Executive Vice President
Gary A. Davis, Vice President
Ready Italy, Inc.
Gene Cortese, President

JOINT VENTURE

Sunflower Food Processors, Inc.
John Reed, President

national advertising



Reader's Digest. NCAA Basketball. The Today Show. The Merv Griffin Show. The Tonight Show. NCAA Football. This is the IPHFHA National Media Schedule for Pizza Hut in 1971. 17,500,000 copies of the magazine and over 362,000,000 television home impressions! Reader's Digest and all of the television programs were selected with one other primary objective besides their big numbers—their ability to reach Pizza Hut's primary audience.

All the 1971 Pizza Hut advertising materials have been designed to tell the following story:
We serve more pizza than anyone else in the world because of quality product, friendly atmosphere, and excellent service.

INTERNATIONAL PIZZA HUT FRANCHISE HOLDERS ASSOCIATION

Daniel Hesse,
Association Director
Michael L. Stegman,
Association Administrator
Directors
Bob McNeely, Columbia, S. C.
Bernie Butler, Manhattan, Kansas
Vic Bonat, Annandale, Virginia
Jack Richmond,
San Antonio, Texas
Chuck Quinette,
Fontana, California
Norman Blankenship,
Amarillo, Texas
Kenneth R. Miller,
PHI Representative

Pizza Hut,® Inc.
10225 East Kellogg
Wichita, Kansas 67207

DESIGN: Visualgraphics, inc.